



South African Reserve Bank
From the Office of
the Registrar of Banks

Ref.: 15/8/2

G6/2017

To: Banks, branches of foreign institutions, controlling companies, eligible institutions and auditors of banks or controlling companies

Guidance Note 6/2017 issued in terms of section 6(5) of the Banks Act, 1990

Loss absorbency requirements for Additional Tier 1 and Tier 2 capital

Executive summary

Among other things, the amended Regulations relating to Banks (the Regulations) that were implemented with effect from 1 January 2013 set out the prescribed minimum requirements for capital instruments to qualify as either Additional Tier 1 or Tier 2 capital.

This guidance note serves to inform all relevant persons of matters related to the loss absorbency requirements and the relevant trigger events for capital instruments.

This guidance note replaces Guidance Note 7 of 2013

1. Introduction

- 1.1 In view of the implementation of the Basel III framework on 1 January 2013, the amended minimum requirements for Additional Tier 1 and Tier 2 capital instruments, for banks and controlling companies (collectively referred to as banks), are set out in the Regulations that were implemented with effect from 1 January 2013. The Regulations have subsequently been amended, with amendments effective 1 July 2016.
- 1.2 This Office provided initial guidance to banks in terms of loss absorption at the point of non-viability in Guidance Note 2 of 2012, section 2.2, issued on 8 February 2012; Guidance Note 3 of 2013, issued on 11 June 2013 as well as Guidance Note 7 of 2013 issued on 18 August 2013.
- 1.3 This guidance note replaces Guidance Note 7 of 2013, issued on 18 August 2013 and banks are advised that this Office will continue to monitor international developments around the loss absorption requirements and, should it become necessary, issue further guidance.

2. Trigger event specified

- 2.1 Regulations 38(11)(b)(i), 38(11)(b)(iv)(H) and 38(12)(a)(i) of the Regulations prescribe that the contractual terms and conditions of the capital instrument shall contain a provision that requires the instruments to be either converted to the most subordinated form of equity, or be written off at the discretion of the Registrar at the occurrence of a specified trigger event.
- 2.2 The trigger event for both Additional Tier 1, accounted as equity, and Tier 2 capital instruments shall be at the discretion of the Registrar as envisaged in regulations 38(11)(b)(i) and 38(12)(a)(i) of the Regulations.
- 2.3 The trigger event for Additional Tier 1 capital instruments, accounted as liabilities, shall be the earlier of the decision by the Registrar as envisaged in regulations 38(11)(b)(i) of the Regulations or when a bank or controlling company's Common Equity Tier 1 (CET 1) ratio is equal to or below 5.875 per cent.
- 2.4 Banks will be notified in writing by the Registrar, once it is deemed that the trigger event has occurred.
- 2.5 Banks are required to clearly indicate in the contractual terms and conditions of Additional Tier 1 and Tier 2 capital instruments issued, whether such instruments will either be written off or converted into the most subordinated form of equity at the occurrence of a trigger event, at the discretion of the Registrar, as envisaged in regulations 38(11)(b)(i) and 38(12)(a)(i) of the Regulations.
- 2.6 Conversion or write-off need only occur to the extent that the bank is deemed to be viable again as specified in writing by the Registrar. In terms of statutory ranking, Additional Tier 1 instruments are likely to be converted or written off prior to any conversion or write-off of Tier 2 instruments.
- 2.7 The instruments to be converted or written off will be determined by the Registrar and shall be based on the book value of the instruments as reflected in the bank's financial statements or management accounts at the time of occurrence of the trigger event.
- 2.8 In the event that a bank has more than one type of capital instrument qualifying as Tier 2 capital, containing either a conversion or write-off provision, such instruments will be treated *pari passu*, meaning that partial conversion or write-off could occur at the occurrence of the trigger event, up to the point that the bank is deemed viable again. The same would apply where a bank has more than one type of capital instrument qualifying as Additional Tier 1.

3. Conversion to most subordinated form of equity

- 3.1 Banks shall include in the contractual terms and conditions for Additional Tier 1 and Tier 2 instruments, which provide for conversion into the most subordinated form of equity, the following information:

- 3.1.1 number of shares or a formula to determine the number of shares in the most subordinated form of equity to be received by Additional Tier 1 and Tier 2 instrument holders at conversion; and
- 3.1.2 the conversion price shall be determined as the greater of:
 - 3.1.2.1 the arithmetic mean of the closing price of the shares on each of the 5 consecutive dealing days prior to the date of the trigger event, or
 - 3.1.2.2 a floor price of 20% of the shares closing price at the same date as issuance of the capital instrument.
- 3.2 In exceptional instances when, following a trigger event, the conversion of a capital instrument:
 - 3.2.1 cannot be undertaken;
 - 3.2.2 is not irrevocable; or
 - 3.2.3 will not result in an immediate increase in CET1;

then such an instrument shall, instead of being converted into the most subordinated form of equity, be written off and result in an increase in the bank's CET1.

- 3.3 Conversion shall occur in the form of listed ordinary shares of the relevant bank, if such bank is listed on an exchange, or alternatively that of the banks' controlling company if the said bank is a wholly owned subsidiary.
- 3.4 In the event of neither a bank nor the bank's controlling company being listed on an exchange, the issuing bank needs to determine a conversion price at date of issuance determined as 20% of the book value of the shares.

4. Instruments written off

- 4.1 Instruments issued with a provision for write-off shall be written off permanently with no provision for a write-up once the bank becomes viable again.
- 4.2 The value of the capital instruments to be repaid in the event of an early call or redemption, for instruments partially converted or written-off, shall be irrevocably reduced to the written-off amount of the instrument.

5. Group treatment

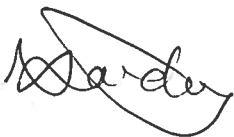
- 5.1 Capital instruments issued out of a fully consolidated subsidiary included in the consolidated amount of qualifying capital shall, in accordance with regulations 38(11)(b)(i) and 38(12)(a)(i), be converted or written off at the occurrence of a trigger event that is the earlier of either the circumstances envisaged in paragraphs 2.2 and 2.3 above, or a decision by the relevant host regulator that a write-off without which the subsidiary would become non-viable is necessary

6. Statutory legislation

- 6.1 The South African Reserve Bank and the National Treasury are in the process of drafting legislation for the South African recovery and resolution regime that will also make provision for statutory bail-in. This legislation will also cover trigger events at the point of non-viability for purpose of that legislation and it is foreseen that the capital ratio related triggers will be similar.
- 6.2 It is foreseen that once this legislation becomes enforceable, the contractual terms and conditions regarding conversion or write-off of instruments already issued and qualifying as capital as per regulations 38(11) and 38(12) of the Regulations are likely to take precedence over the relevant statutory legislation requirements, once the specified trigger event is breached. Therefore, the contractual terms and conditions remain in force for instruments issued prior to the introduction of the statutory legislation.
- 6.3 Banks have the option to state in the contractual terms and conditions, of the capital instruments issued, that once this statutory legislation becomes enforceable, it then replaces the contractual terms and conditions and would therefor continue to qualify as capital.

7. Acknowledgement of receipt

- 7.1 Kindly ensure that a copy of this guidance note is made available to your institution's independent auditors. The attached acknowledgement of receipt duly completed and signed by both the chief executive officer of the institution and the said auditors should be returned to this Office at the earliest convenience of the aforementioned signatories.



Kuben Naidoo
Deputy Governor and Registrar of Banks

Date: 14/08/2017

The previous guidance note issued was Guidance Note 5/2017, dated 28 July 2017.

Encl.